Consumers Union

'ublisher of Consumer Reports

February 5, 2003

Department of Corporations, State of California
Attn: Kathy Womack, Associate Program Analyst
Office of Law and Legislation
1515 K Street, Suite 2000
Sacramento, CA 95814

Via Facsimille (916) 322-3205

Re: A Study of Consumer Credit Counseling Agencies in California

To Whom It May Concern:

Consumers Union writes in response to your Survey of Debtors regarding the fees charged by nonprofit consumer credit counseling organizations. We appreciate the opportunity to respond to this survey. Specifically, we have been asked to answer questions 4-7.

Background

Consumer revolving debt has increased by ten times in the past twenty years and is now at a level of $680 billion. This increase in household debt and the general rise in the availability of credit has resulted in increased demand for credit counseling and an explosion in the debt industry. In the year 2000, three million consumers sought help from credit counselors.

Throughout the 1990s the debt industry boomed and over the course of the past ten years competition grew between traditional Credit Counseling Services who are affiliated with the National Foundation for Credit Counseling and provide education, budgeting services and debt management plans and smaller and more business-like nonprofit credit counselors. These smaller groups now comprise nearly forty-five percent of the industry. Consumers Union supported AB 2293 (Lui) because it begins to regulate all members of this industry who claim nonprofit status.

Question 4: California limits the fee that may be charged monthly for the service of paying a debtor's bill to $20. This cap has not increased in 20 years. What is a reasonable fee limit, and why?

Absent an increase in other allowable fees, it would be appropriate to grant an increase for credit counseling providers which reflects the Consumer Price Index (CPI). The CPI measures price of a constant bundle of goods over a period of time and is

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frequently used to consider the present value of money from one period of time to the next. The CPI in 1982 for the Western Urban area was 97.4. In 2002 the number was 184.7. In short, the present value of $20 in 1982 was $37.93 at the end of 2002, a difference of $17.93.

But, credit counselors are now permitted under California statute to charge a one-time education and counseling fee of $50 from debtors that they were not explicitly permitted to charge before the enactment of this statute on January 1, 2003. Consumers Union recognizes that the $20 fee is an ongoing monthly fee. Even still, the increase in the education fee covers the difference between the present day value of the $20 fee nearly three times. Furthermore, charging consumers this education and counseling fee is not contingent upon a consumer entering a debt management or debt settlement plan. Arguably, consumers who do not enter debt management plans may now be charged the $50 counseling and education fee, providing credit counselors a new and expanded revenue stream.

Because this $50 is well over the present day value of $20 in 1982, Consumers Union sees no reason to increase the monthly fee for servicing a consumer's debt at this time. We urge the Department to recommend to the Legislature that this fee remain the same until the impact of the increased education and counseling fee is fully understood.

5. California limits the amount that may be charged for a debt settlement plan to 15% of the amount of the debt forgiven. Is this limit reasonable?

The fee permitted for a debt settlement plan is new. Because this is the first time that the Department will regulate the provision of such services, Consumers Union does not yet have an opinion on the cost of the provision of such services. We do caution the Department from considering any fee increases at this time.

6. California limits the amount that may be charged for education or counseling in connection with debt management or debt settlement services to a one-time sum of $50. Is this amount reasonable?

This fee of $50 is a new source of revenue for credit counselors. Consumers Union recognizes that nonprofit credit counselors provide a service to consumers and that these counselors need to be compensated for the services provided. As discussed in response to Question 4, Consumers Union has concerns about the amount of the fee increase in light of the Consumer Price Index. Thus, we do not think that any increase over the $50 should be provided.

7. Do you believe that caps on fees are necessary or beneficial? Why or why not?

Consumers Union believes that caps on the fees are both necessary and beneficial to consumers. The July 2001 *Consumer Reports* outlined many of the problems that consumers face when working with credit counselors. One such problem highlighted in the article was the fees that were charged to consumers. Because of the way the law was drafted before the enactment of AB 2293 some credit counselors charged excessive fees for their services. According to *Consumer Reports*, one large credit counselor charges an initial fee equal to a consumer's first monthly payment and a monthly fee of $7 per account. (See attached article.)

In this instance the market has not worked, and debtors, who are in serious financial trouble, are then taken advantage of by unscrupulous counselors. Because of these abuses, caps are both necessary and beneficial to consumers.

Consumer Union appreciates the opportunity to respond to the survey regarding the cost of services for credit counseling services. Because credit counselors are now permitted to charge fees to consumers well in excess of the present value of the previous fees permitted by statute, we do not think that there is any justification for any additional fee increases to consumers at this time.

If you have any questions, please do not hesitate to contact me at (415) 431-6747.

Sincerely,

Shelley Curran

Shelley Curran
Policy Analyst

Pushed off the financial cliff

Growing numbers of overextended consumers are turning to credit-counseling services. The help they find may not be enough.

Millions of ordinary middle-income consumers are skating on the edge of financial ruin. A half step ahead of their clamorous creditors, they know that a job loss, sudden illness, leaking roof, or divorce can easily topple budgets that are already weighed down by barely affordable mortgages, car payments, and credit-card debts.

The refuge of last resort from bill collectors, lawsuits, and foreclosures, of course, is bankruptcy. But the price is steep—loss of possessions, loss of dignity, and a ruined credit record debtors will be forced to live with for a decade.

Despite those disincentives, every year since 1996 more than a million households—a large proportion of them headed by college-educated and white-collar workers who had never dreamed their comfortable lives and high expectations would crash and burn—have had to seek relief from their debts in bankruptcy. Already, personal bankruptcies in 2001 could exceed the 1998 record of 1.4 million, according to SMR Research Corp., a credit-industry research firm in Hackettstown, N.J.

The only alternative for 30 years has been the nation's credit-counseling agencies, an emergency 911 service for people in financial distress. Funded chiefly by creditors who hope to recoup some of their money from insolvent borrowers, these nonprofit agencies originally aimed to help people pull themselves out of their borrowing pit through a debt-repayment plan, a creditor-approved arrangement that allows consumers to repay their unsecured debts at reduced interest rates. Last year, an estimated 3 million borrowers turned to credit counselors for help.

With the economy slowing and consumers' load of revolving debt topping $680 billion—a more than tenfold increase over the past 20 years—the number of floundering borrowers turning to credit counseling is sure to grow.

A new bankruptcy reform bill, which has passed both the House and Senate and which President Bush says he'll sign, will make matters even worse. Under the new law, anyone contemplating bankruptcy must first be briefed on the credit-counseling option. Robert Manning, a research fellow at the University of Houston Law Center and author of "Credit Card Nation," anticipates that within a year of the law's passage, the number of people asking counseling agencies for help could increase by one-third. "Counseling agencies will be absolutely overwhelmed," he says.

Those who fail under the new system could face a protracted period of financial pain. Under current law, debtors declaring bankruptcy could file for Chapter 7 protection, through which their unsecured loans (mainly credit-card charges and medical bills) would be erased, but they could lose their assets (including their home and cars, but excluding retirement savings). Or they could opt for Chapter 13, which would oblige them to repay creditors but let them keep their possessions.

The reform legislation will make it much harder for debtors to get a fresh start. Only wage earners whose household incomes are below their state's median (the U.S. median for a family of four was recently $59,981) will be permitted to file under Chapter 7. Everyone else will be required to file under what will be more stringent provisions of Chapter 13, which will force debtors to live on a government-prescribed allowance and repay lenders under a court-supervised plan. If they still can't keep up, debtors could find themselves in a financial purgatory. The court could dismiss their case, exposing them anew to hounding by collection agencies, paycheck garnishees, and lawsuits that would eventually strip them of assets until they are pauperized enough to file under Chapter 7. The new law, says Manning, "will drive many people outside the formal economic system." (See page 23 for the path would-be bankruptcy filers will have to take, and turn to page 22 for an idea of what their allowance could look like.)

In this report we gauge whether credit-counseling agencies can handle their new burden and how much help debtors might expect. Among the key findings:

- The credit-counseling industry is divided into two rival camps—an older group, many of whose members function like slow-moving social-services agencies, and a new, more commercial breed that capitalizes on high-tech communications and payment systems to speed up the delivery of services.
- Both counseling groups are chronically underfunded by the creditors who cover the bulk of their operating expenses. As a

result, neither is able to serve debtors particularly well.

• Though they are the main beneficiaries of the counseling process that extracts payment from debtors, creditors have become much stingier in granting the concessions that would reduce and spread out interest payments—the key to a workable debt-restructuring plan.

In a near-total absence of government oversight, agencies have been free to offer counseling that ranges in quality from wise and caring to hapless and ill-informed. Under the new law, Congress sets standards that counseling agencies will be expected to meet, but whether those standards will ensure debtors receive high-quality counseling is far from clear.

A FINANCIAL RESCUE SERVICE

Credit counseling can be a financial lifesaver when it's done right. Consider the experience of a 31-year-old marketing coordinator whose counseling session we witnessed (and who insists that her name be kept confidential). Last March, she went to the Consumer Credit Counseling Services of the Mississippi River Valley, in St. Louis, after collectors pressed her to repay $9,000 in debts that her husband had accumulated while starting a business. She spent an intense hour-and-a-half session going over with counselor Christopher Jones every dime the couple earned, spent, and owed.

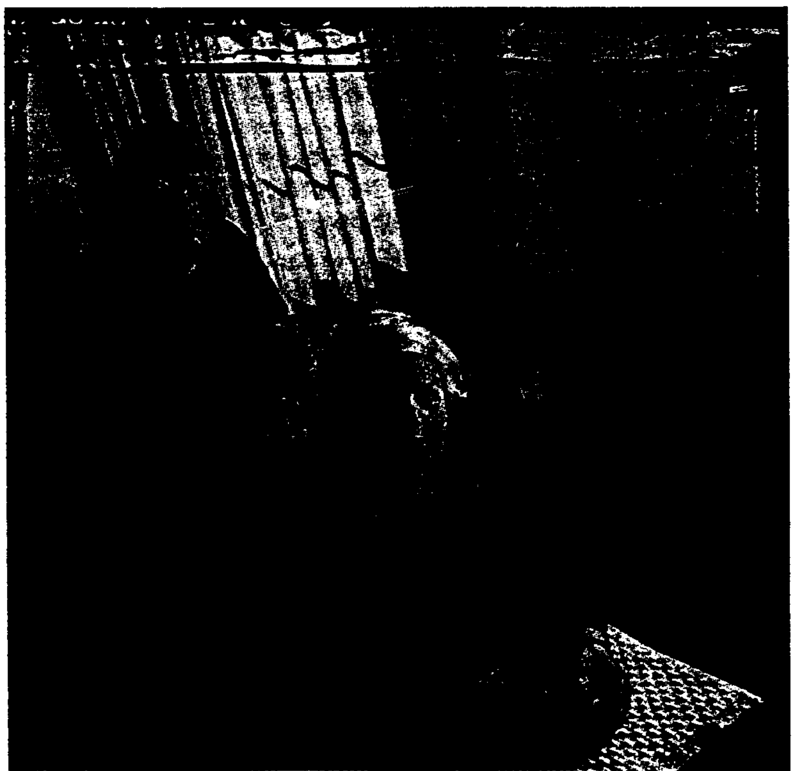
Drawing on his college training in psychological counseling and his experience as a bank loan officer, Jones, 32, helped the couple identify $200 in monthly budget cuts. He also recommended that they participate in a debt-management plan that he would set up, agreeing to repay everything they owe and take no new debt. In exchange, creditors would reduce interest rates on unpaid balances. The debtors make one monthly payment to the counseling agency, which in turn disburses funds to the creditors. By enrolling in a plan their creditors approve, Jones told his client, the couple could cut their monthly payments in half, to about $300. Doing so would go a long way toward closing the gap between their $3,400 monthly spending and their take-home pay of about $2,800 and make them debt free in 31 months. Relieved, the woman assented. "I couldn't go on living like that," she said.

What made the couple's program effective was a qualified counselor, able to draw upon an array of tools to craft a manageable way for overextended borrowers to regain their financial footing while meeting their obligations to lenders. But that experience is not what consumers always find these days.

BUREAUCRATS AND ENTREPRENEURS

Two broad groups of agencies provide the bulk of counseling services.

The traditionalists. For 20 years, people in financial trouble turned to Consumer Credit Counseling Services, a network of local offices created by the National Foundation for Credit Counseling, a creditor group whose stated aim is to provide an alternative to bankruptcy. Operating almost like social-service agencies (many are affiliated with multipurpose, nonprofit family and children's services), these organizations historically offered face-to-face counseling in neighborhood centers that were little more inviting than state unemployment offices.



Bothered by bureaucracy Maryland residents Robert and Diana Taggart felt patronized and put out trying to work with a traditional credit-counseling service as they struggled to pay off $30,000 in credit-card debt. Switching to a more businesslike agency that relies on telephone counseling and electronic payments, they've managed to shrink their debt by $5,000.

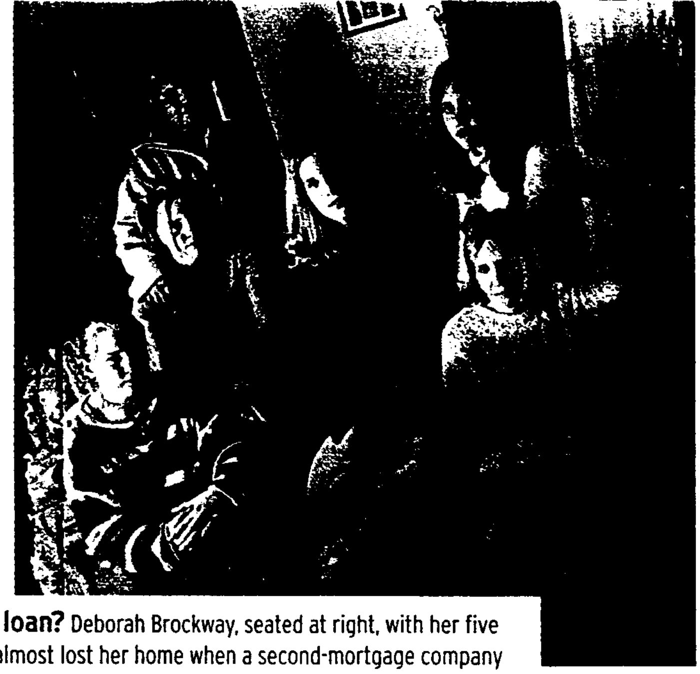
PHOTOS BY KINORA CLINEFF

For creditors, the local agencies have been astoundingly successful. Last year, their debt-repayment plans recouped some $2.5 billion that might have otherwise been lost in bankruptcy. Clients haven't been as well served. In a 1999 confidential member-activity report, the federation examined what happened in the 273,473 debt-workout cases its 1,300 local agencies closed that year. It found that just 21 percent of the clients successfully completed a debt-management plan. Another 21 percent decided to administer their own pay-back plans. And while just 4 percent filed for bankruptcy, 47 percent simply stopped paying and disappeared from view.

A new breed. The unbridled marketing of credit cards made debt a growth industry by the early 1990s, opening opportunities for a new variety of independent credit-counseling agencies to promote their services. The newcomers, including outfits called Auriton, Garden State Credit Counseling, and Genus, promised privacy and speedy results. They functioned "more like businesses than social-service agencies," says Bernie Dancel, founder of Genus.

Like the traditional Consumer Credit Counseling Services, these independents also structured themselves as nonprofits. When some tried to affiliate with the federation, however, they were rejected by traditional counseling services that didn't want them encroaching on their turf. So the mavericks created a separate trade group named the Association of Independent Consumer Credit Counseling Agencies. Using mass-market advertising to reach debtors and offering them the convenience of more flexible telephone counseling, the new agencies quickly built large client lists. Together with other independents, those agencies now represent about 45 percent of the credit-counseling business.

The traditionalists disdain the independents as "DMP mills" (DMP stands for "debt-management plan") for cutting corners in their eagerness to sign up clients. But we found no evidence to suggest that clients who are counseled by an independent are any less successful in completing debt-repayment plans than those who use a traditional counseling service.



Home a loan? Deborah Brockway, seated at right, with her five children, almost lost her home when a second-mortgage company didn't receive its expected payment. Her counseling agency failed to recognize that a home loan was improperly listed in a debt-repayment plan, forcing her and her husband, Irvin (not shown), to scramble for the cash to save their house.

Indeed, some of the newer agencies have clearly been a boon for consumers such as Diana Taggart, 49, and her husband Robert, 58. The Taggarts left the Army ten years ago with $30,000 in credit-card debt they'd run up moving from one posting to another. The couple turned initially to a Consumer Credit Counseling Service in Maryland for help and stuck with the agency for two frustrating years. Their counselor, they said, "treated us like imbeciles" and plagued them with inconveniences. To make a payment on their debt-management plan, for example, the Taggarts had to get cash, purchase a money order, and hand carry it to the credit-counseling office.

Those annoyances disappeared when the Taggarts switched to Harbour Financial, a credit-counseling service based in Virginia Beach, Va. Conducting most of their business with with the new agency by telephone, the Taggarts now arrange to have funds debited electronically from their bank to their debt-management account. They hope to be finished with their debt-repayment plan after another three years.

QUESTIONABLE ETHICS

While many of the traditional counseling agencies suffer from an excess of stodginess, a few of the independents we examined appear to be more interested in their own financial well-being than that of the debtors they're supposed to serve. AmeriDebt, based in Germantown, Md., for example, assured clients they would most likely be approved for a debt-consolidation loan from Infinity Resources, in Washington, D.C., after they had made six payments on their debt-management plan. In fact, AmeriDebt steered its clients' first payments not to creditors but to Infinity, according to court documents filed by the Washington, D.C., corporation counsel who filed charges against the companies in 1999.

Charging the companies with deceptive lending practices after clients complained that they had received no loans, the prosecutor, Bennett Rushkoff, discovered in the course of his investigation that Infinity was owned by Andris Pukke, AmeriDebt's founder. Without admitting to any wrongdoing, AmeriDebt and Infinity settled the case last spring for $1.5 million, most of which has been refunded to clients.

Pukke has withdrawn from AmeriDebt's management, but that hasn't severed his ties with the business. AmeriDebt outsources back-office customer service to another Pukke-owned for-profit business called Debtworks. The arrangement would be ethical if the nonprofit's board were independent and made decisions that would not benefit its own members, says Marion Fremont-Smith, senior research fellow at Harvard's Hauser Center for Non-Profit Organizations in Cambridge, Mass. But AmeriDebt's 1998 tax filing (the most recent that is available) listed Pamela Shuster, Pukke's wife, as a board director. She served as the company's vice president until mid-1999, AmeriDebt confirmed.

CREDITORS TIGHTEN THE SCREWS

Even the best-run counseling services can't offer debtors much help unless creditors are willing to cooperate with them. Until recently, lenders generally agreed to admit debtors to a debt-management plan pretty

Life on an IRS allowance

Under a new federal bankruptcy law, a debtor would be able to declare bankruptcy only after first being made aware of the credit-counseling option. If the debtor's family income exceeds the state median for a household its size, the debtor may be required to repay a portion of what's owed. To meet living expenses, the family must adhere to a budget devised by the Internal Revenue Service. The family would continue to pay its mortgage if it owned a house; otherwise, rent, utilities, and related costs would be determined from a schedule of prevailing local rents for a family its size. The family would continue making car payments, but the budget also allows for maintenance, fuel, and insurance costs based on where the family lives and the number of vehicles owned. Expenses for food, apparel, and other personal items are based on national averages.

Here's what a family of four with a gross monthly income of $5,000 might have to live on in Fort Worth, Texas (where the median annual income for a family this size is $53,291). We assumed they rent their home and estimated what a court would allow the family to deduct for "other necessary expenses," including child care, medical, and insurance.

Gross monthly income	**$5,000**
Withholding	524
Social Security and Medicare	382
Total taxes	**906**
Maintenance expenses for 2 cars and lease payment	691
Housing and utilities	1,304
Food, clothing, housekeeping supplies, personal care, and miscellaneous expenses	1,170
Total IRS allowance	**3,165**
Uninsured medical expenses, life insurance	110
Child care	500
Total other necessary expenses	**610**
Total expenses	**4,681**
Amount left to repay creditors	**$319**

much on a counseling agency's say-so. But as profit margins in the credit-card industry narrowed in the late 1990s, lenders could not help but notice that credit counseling had become their second biggest collection expense after labor, says a collections executive at a major bank in Philadelphia, who asked for anonymity.

To rein in the rising costs, lenders have thrown new obstacles in the path of credit-counseling clients. Rejections are now common though often illogical. Creditors may refuse to accept debt-plan applicants, for example, even if they had never been late on payments. Creditors reason that relief isn't necessary since the accounts are technically current. But that is not a good indicator of people's continued ability to pay. Credit-industry officials themselves have complained of a spate of "stealth bankruptcies" by customers who made payments on time then unexpectedly filed Chapter 7.

At the behest of creditors, counselors must now elicit answers to more-intrusive questions before accepting applicants. According to a recent letter to agencies with which it works, Chase Bank asked for totals of assets and liabilities that include "all personal property that might reasonably be liquidated or leveraged in order to reduce debt." Included on the list were homes, autos, and retirement plans. Consumers trying to get into debt plans are thus stripped of their privacy even though many such assets would be protected in Chapter 7 and Chapter 13 bankruptcies under both old and new laws. A Chase spokesperson said the information is used to monitor the performance of counseling agencies and not as a basis for rejecting debt-management plans.

For debtors who do win admission to a plan, creditors are imposing tougher terms. Previously, most creditors would drop interest rates to zero for plan participants. Now they will give only a few points, says Suzanne Boas, president of the Credit Counseling Service of Greater Atlanta. Interest rates range from 9 to 14 percent. That's better than the 18 to 25 percent many clients were paying, but high enough to make a plan unworkable for many counseling clients. A 1999 Visa nationwide survey of 481 people who dropped out of a debt-management plan found that one-third of them would have stayed on if creditors had waived interest or fees. Some 42 percent of the dropouts filed for bankruptcy.

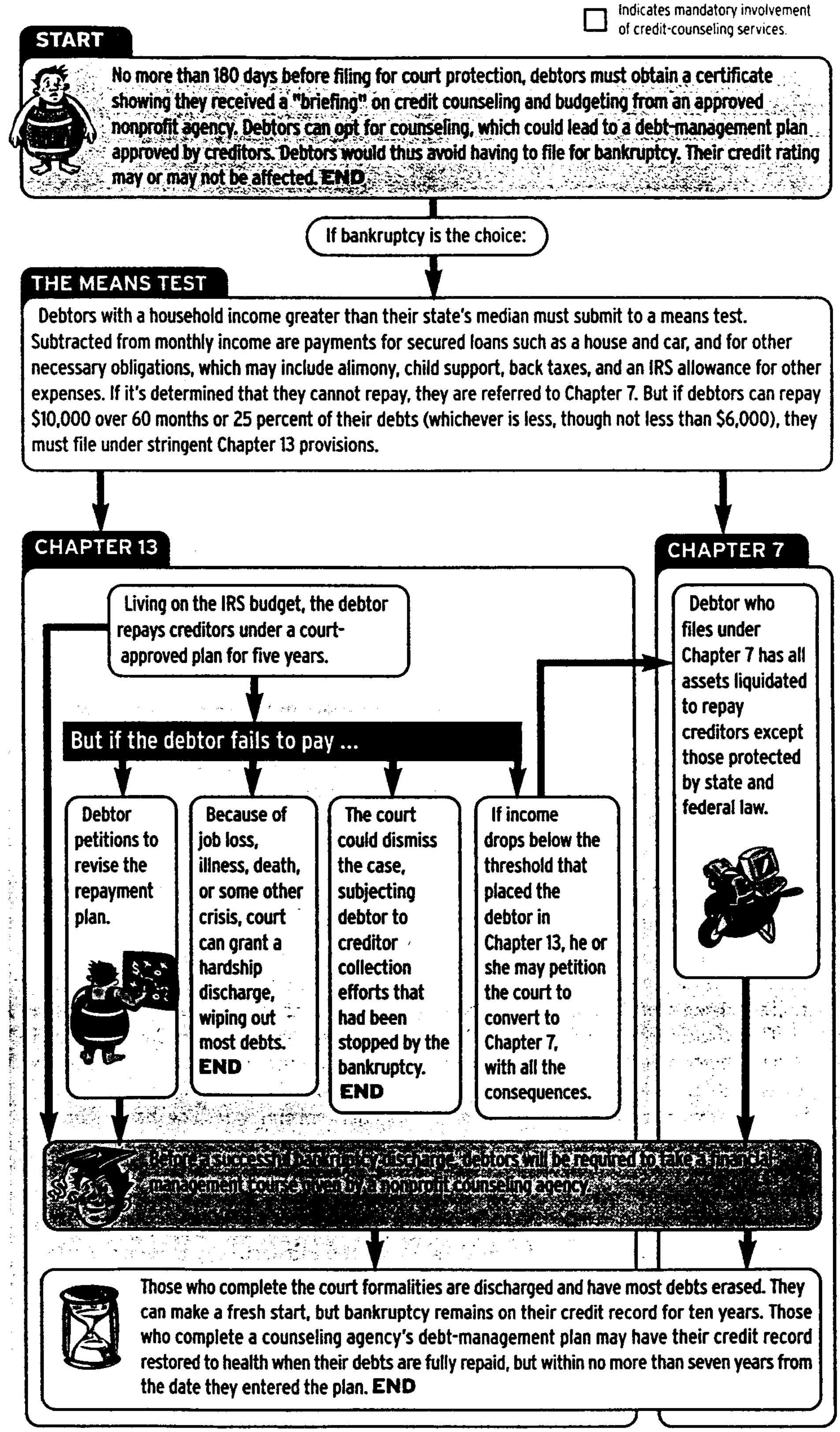
ILLU NS BY JASON LEE

STRAPPED AGENCIES

Members of both credit-counseling groups cover the bulk of their operating costs

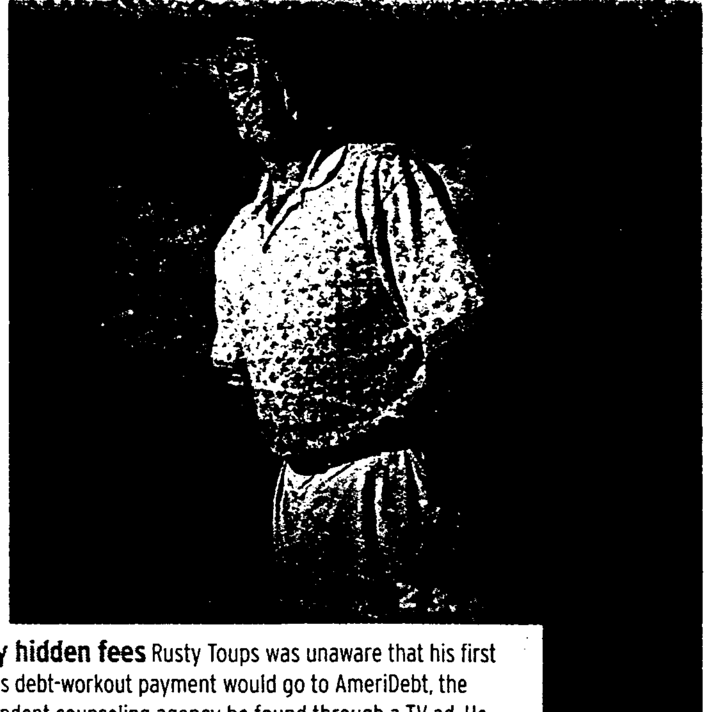
New paths to a fresh start

More than four years in the making, new bankruptcy legislation, which passed the House and Senate this spring, has two major aims: first, to introduce a means test that will curb what creditors say is rampant abuse by people who are actually able to repay their debts; and second, to keep people from filing for bankruptcy without being made aware of the credit-counseling option. Here's how the new law is supposed to work.



through a creditor contribution called "fair share"—historically 15 percent of the revenues returned through debt-management plans. In the past several years, says Durant Abernethy, president of the National Federation of Credit Counseling, creditors have slashed contributions by more than a third, to an average of 9.7 percent last year. Lenders have already announced new reductions for this year.

The deep cuts have forced agencies to close offices, reduce counseling staffs, and curtail educational and community-outreach programs. Even though more people will need their services after the new bankruptcy legislation takes effect, says Joel Greenberg, a founder of the independent counseling-service trade group, "More agencies will have to shut down."



Hit by hidden fees Rusty Toups was unaware that his first month's debt-workout payment would go to AmeriDebt, the independent counseling agency he found through a TV ad. He was hit with more than $200 in late-payment penalties when his accounts went delinquent. Now working with another counseling service, Toups pays $15 per month in account-management fees.

Hurting for funds, counseling agencies across the country are boosting their revenues by imposing fees on consumers, a move that most of the federation affiliates have so far resisted. But among the one-quarter of the group's members who now charge clients, the federation's 1999 member-activity report discloses that fees average $11 for counseling, $17 to enroll in a plan, and $10.50 a month for management of all accounts. For a consumer who enrolls, the cost over five years is $680—money that a hard-pressed borrower could have used to pay down debts or ease the repayment pinch. "It broke my heart to have to introduce fees," says C. Philip Johnston, president of the Consumer Credit Counseling Services of the Mississippi River Valley. "But we couldn't make it without them."

The Association of Independent Consumer Credit Counseling Agencies has set fee limits for its member agencies, but it does not bar them from requesting "voluntary" contributions. Some of the more free-wheeling independents who belong to neither trade group are doing just that. AmeriDebt and Debticated, an agency based in New York's Long Island and headed by Andris Pukke's brother, Erik, ask their clients for an initial contribution equal to the first month's payment, as well as a monthly fee of $7 per creditor account.

Owing several thousand dollars to five different creditors, Rusty Toups, 38, a New Orleans window-blind designer, signed up with AmeriDebt understanding that he'd have to pay the agency $35 a month in account-management fees. But, he says, he did not understand—and remained unaware—that his first $450 payment would be automatically "contributed." Creditors continued to dun him because they never received their money. Only after he complained to a local TV station did AmeriDebt provide him with a refund. By then Toups had racked up more than $200 in late-payment charges.

Jeff Formulak, AmeriDebt's operations manager, says that notice of the voluntary contribution was in Toups' contract. But the contract gives the client no clear way to opt out, which, in our view, makes the voluntary contribution not so voluntary. Recognizing the trap he was in, Toups cut his losses and switched to the Consumer Credit Counseling Service of New Orleans. The new agency charges $20 to set up a plan and $3 per month for each creditor account it services, up to a maximum of $24.

UNKEPT PROMISES, UNEVEN SERVICE

Consumers struggling to pull themselves out of the financial depths need the help of a well-trained counselor. The quality of counseling, however, can range from the skillful and sympathetic advice of Christopher Jones in St. Louis to high-pressure sales tactics. For example, a counselor at Preferred Credit Management in Phoenix, whom our researcher contacted to inquire about the counseling process, seemed interested only in signing her up. "We will need a payment today of $39 for the application," he told her.

The National Federation for Credit Counseling has attempted to standardize counselor training among its 1,500 affiliates' offices. Counselors, who come from a variety of backgrounds including banking, teaching, social services, and collections, are not required to have a college degree. But they must pass exams in six courses given over a year that cover personal finance, lending, and budgeting. The independents' trade group has not specified uniform standards to which its members should be expected to adhere. And at unaffiliated counseling services, training may last only a few days or weeks.

Poor counseling can lead debtors down a treacherous road. Deborah Brockway, a waitress from Loveland, Colo., says she almost lost her home after she and her husband, Irvin, a cattle hauler, signed onto a debt-management plan with Debticated. Only after she was threatened with foreclosure did she learn that Debticated sent only $21 a month to the second mortgage company when their bill was $519.

Like all collateralized lenders, mortgage holders do not make debt-workout concessions, a point Dan Ruggiero, Debticated's director of operations, concedes. Yet he insists that the fault was entirely Brockway's. She shouldn't have included the second mortgage in the program, he says. But a Debticated counselor should have caught the error.

Service glitches. Clients should get prompt and careful service and ongoing help from counselors. Yet slipshod account management can put them in hot water with creditors. For example, many agencies disburse payments they collect from their debt-management-plan clients just once a month. But some rely on the clients to inform their creditors to expect payment on that schedule. Predictably, clients may not understand that their failure to reset the payment schedule with their creditors can lead to late-payment penalties.

Another common problem: Counseling agencies tell clients to stop paying their bills and direct payment to the counseling agency before creditors have accepted them for a debt-management plan. When payments don't come in, creditors turn accounts over to bill collectors or lawyers, who pester debtors with phone calls or file a lawsuit against them.

RECOMMENDATIONS

For all its imperfections, credit counseling has saved many people from insolvency. Now it has come under so many financial pressures that it could be strained to the breaking point without new support or commitment to reform. Here are the issues that each party with a stake in the process needs to address:

What Congress should do. To ensure the efficacy of the credit counseling required by the new bankruptcy law, Congress has laid out basic standards that counseling services will have to meet to be included on a list of approved agencies. The U.S. Trustees, a Department of Justice bankruptcy overseer, will develop a certification process. But to make it meaningful and thorough, Congress must provide the resources to do the job.

What states should do. Only 17 states now regulate credit-counseling services. States will need to step up oversight to ensure that customers' money is safe, that credit-counseling agencies refrain from sideline businesses that sell customers more debt, and that counselors have an appropriate level of financial training to give people sound advice.

What credit-counseling trade associations should do. The Association of Independent Consumer Credit Counseling Agencies must challenge its members to meet at least the counselor-training standards of the Consumer Credit Counseling Services network. Both trade groups should set aside their rivalry and join forces to take a stronger stand against creditor cutbacks of fair-share contributions and concessions to debt-management-plan participants. Allowing creditors to play one group against the other, as they appear to be doing now, will only send contributions lower. It will be consumers who suffer the consequences.

What credit-counseling agencies should do. Debtors are now paying for counseling services, and they deserve to be treated like customers. That means offering flexible hours for face-to-face meetings and hiring skilled counselors to help people dig themselves out of debt, financial planners to help them save and invest, and lawyers to advise them on bankruptcy. Agencies should also be required to gather and disclose debt-management-plan retention rates to the public so that potential customers can shop intelligently.

What creditors should do. Credit counseling pays off big-time for banks and retailers who otherwise would lose what they are owed when customers file for bankruptcy. Creditors should restore fair-share contributions to 15 percent, enough to allow agencies to fill out the range of financial counseling services their clients need. To ensure the money is spent wisely, creditors should direct more to agencies that can demonstrate strong retention rates for the debt-management plans they oversee.

Creditors should be more flexible in what they demand from people who need debt relief. Instead of merely reducing interest rates and fees, creditors should reduce debts. Even under the revised Chapter 13 bankruptcy, creditors get back only about 60 percent of their money, says Todd Zywicki, a bankruptcy expert and professor at George Mason University Law School, in Arlington, Va. Accepting a compromise payment of 75 or 85 percent from customers in a debt-management plan would make them more likely to succeed.

Creditors have long argued that "deadbeat" debtors who filed for court protection under the old law impose a "bankruptcy tax" on every American family. When the new law is in place, American families should see a bankruptcy-tax cut in the form of lower interest rates and penalties on revolving credit.

What consumers should do. With the consequences of insolvency likely to become more severe and longer lasting, people must exercise more caution in using credit. A good rule for spotting whether debt has gotten out hand: If total debt payments, excluding mortgage and car, are between 25 and 50 percent of after-tax annual income, the borrower should consult a counseling agency at once. But consumers should choose carefully. They can find good and poor counseling among the traditional credit-counseling services and the newer variety. There are tremendous variations among the agencies, so it makes sense to get thorough answers to the questions we list in the box below before committing to a debt-workout program.

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What to ask when looking for credit counseling

Here are seven questions consumers should ask credit-counseling service providers before signing up for a debt-management program. When our researchers inquired about the process followed by agencies in three cities, they found a big gap between the best and worst answers.

QUESTION	BEST CASE	WORST CASE
[illegible]	[illegible] discussion of finances [illegible] problem, action plan, and support afterward.	Filling out an application for a debt-management plan.
2. How much training do counselors have?	College degree plus courses in lending, credit, budgeting, saving, and investing; continuing training in home finance and bankruptcy.	Two weeks, mostly on how to operate computer system and phones.
3. What information do counselors need to make an assessment?	Pay stubs, recent loan and credit-card statements, and a budget form filled out as fully as possible, submitted before counseling begins.	Off-the-top-of-the-head estimates.
4. What is the most I will have to pay?	Free initial consultation; debt-management-plan fees—$15 to set up account, $10 to $15 monthly service charge. Counseling only, $25.	Sign-up fee for consultation. Up-front charge of 3 percent of total debt to set up a debt-management plan; monthly charge of $7 per creditor account.
5. What are your other sources of income?	Fair share from creditors; grants from nonprofit foundations or charitable gifts.	Fair share from creditors; referral fees from debt-consolidation or second-mortgage companies; money from payday lenders.
6. How long is the wait for counseling?	Only as long as it takes to mail or fax documents.	Two weeks plus.
7. How long does the counselor take to assess finances?	Ninety minutes.	Twenty minutes.